STRICTLY CONFIDENTIAL (FR) CLASS I-FOMC

Material for

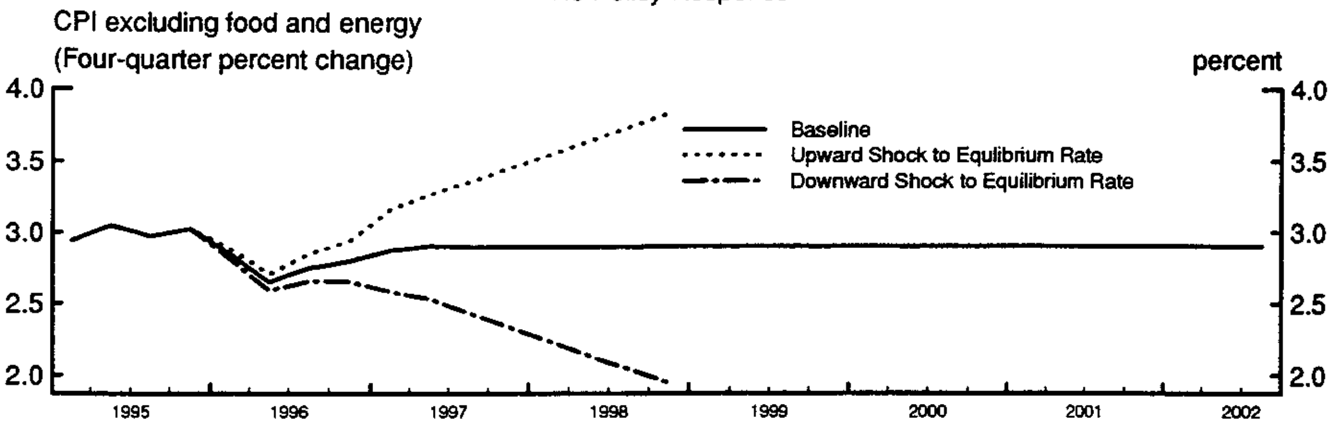
FOMC Monetary Policy Briefing

January 31, 1996

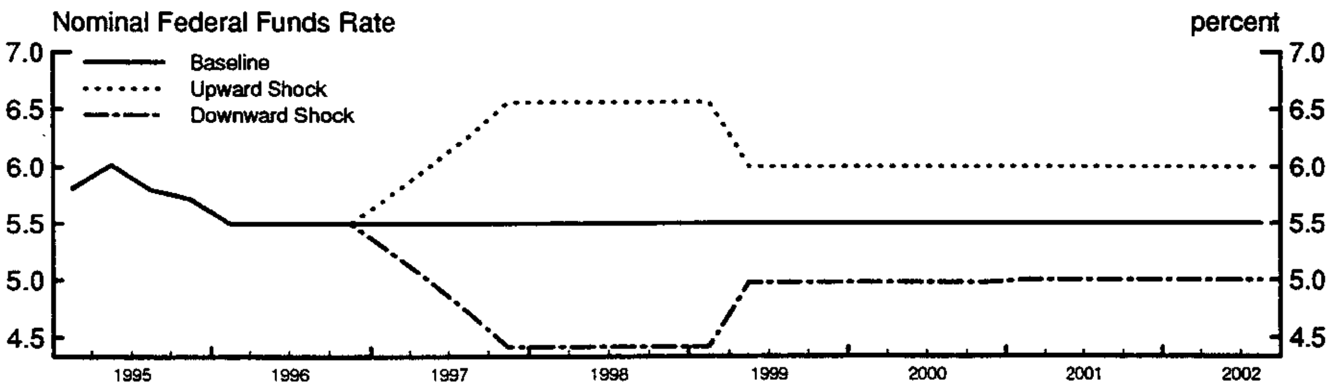
Exhibit 1

SHOCKS TO THE EQUILIBRIUM REAL FUNDS RATE
(FIFTY BASIS POINTS)

No Policy Response



Lagged Policy Response



Lagged Policy Response

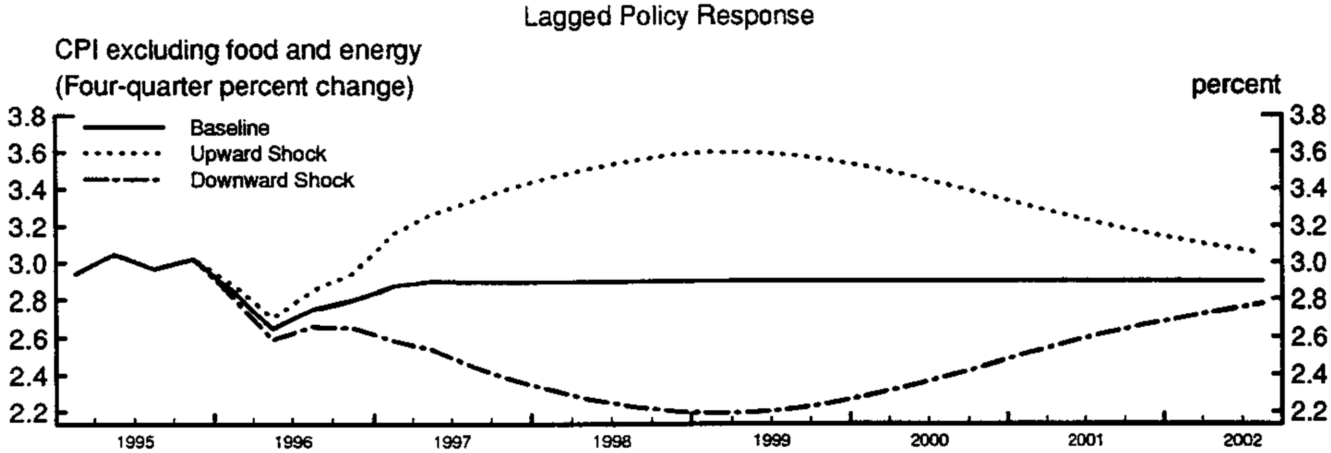
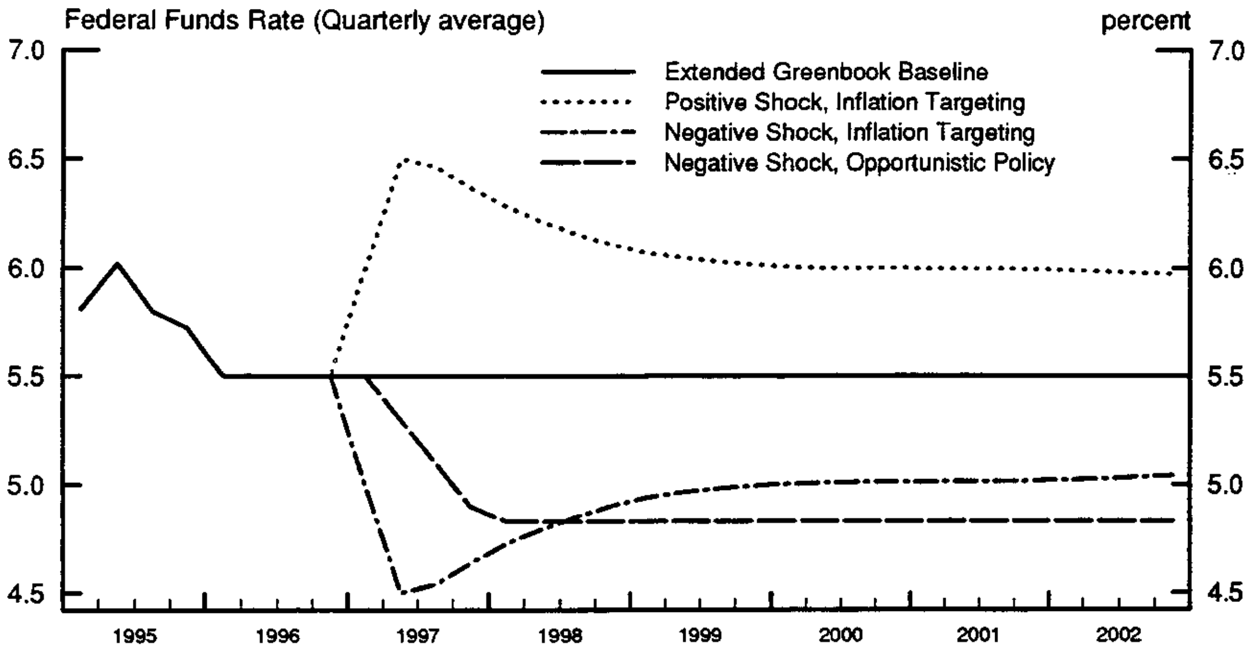


Exhibit 2

Alternative Monetary Responses
To a Permanent 50 Basis Point Shock
To the Equilibrium Real Interest Rate



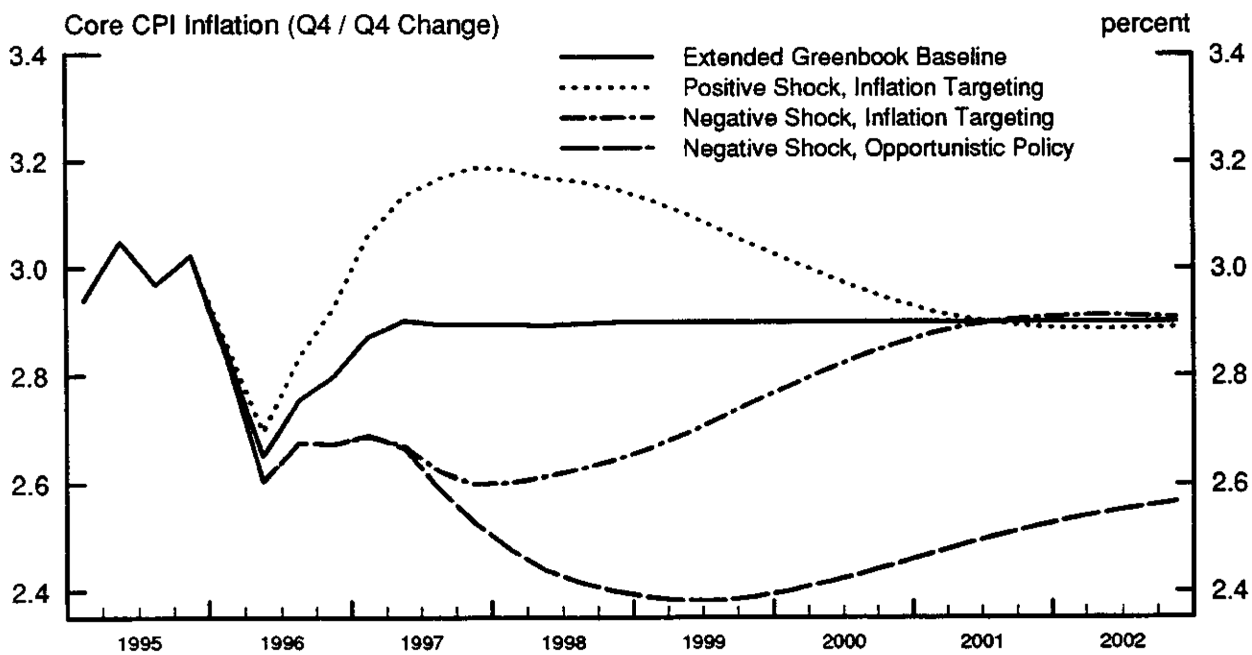


Exhibit 3

Monetary Policy and the Role of Bond-Market Expectations: Effect of a Permanent 50 Basis Point Rise In the Equilibrium Real Interest Rate

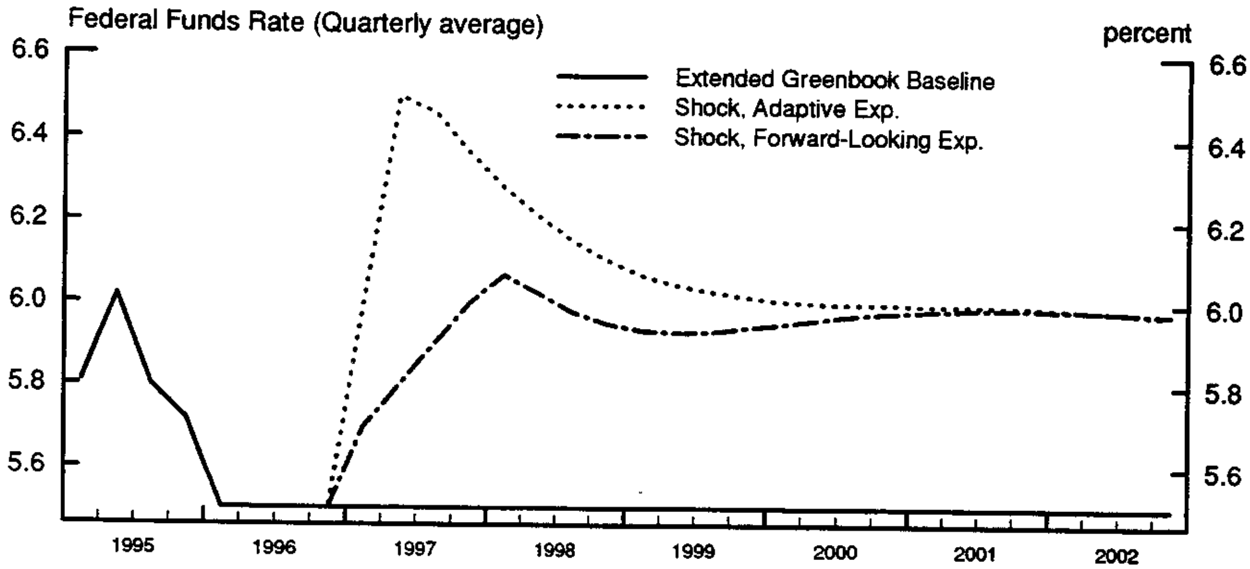


Exhibit 4

Some lessons

1. Monetary policy faces uncertainties:

   - About the level of equilibrium rates

   - About the transmission mechanism of policy

2. Slow reactions to changed circumstances risk policy errors that can be difficult and costly to reverse.

3. A bond market that correctly anticipates the Committee's actions can play a helpful stabilizing role, allowing the Committee to move cautiously for a time.

4. Greater uncertainty implies the need for flexibility in policymaking.

5. An opportunistic strategy entails stronger reactions to possible increases in inflation than to possible decreases.